Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

Case No. 85-1860

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1985

R. S. COWLES and GLORIA B. COWLES,

Petitioners,

v.

DOW KEITH OIL & GAS, INC., an Oklahoma corporation, and DOW KEITH, individually,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

QUESTIONS PRESENTED FOR REVIEW

1. Was it proper for the federal court of appeals to affirm the fedral district court's holding that the sales of securities sold to Petitioners by Respondents were exempt transactions pursuant to a statute, the exemption requirements of which obviously were not met, whereby the district and appellate courts have judicially created a securities transactional exemption which does not statutorily exist, said courts having therefore created legislation in violation of the separation of powers doctrine?

2. Should this Court in the exercise of its supervisory powers reverse the federal court of appeals, which, by affirmation, has created a decision described as a "horrible aberration" by Professor Joseph C. Long, President of the North American Securities Administrators Association, in his treatise, Blue Sky Law,

the appeals court thereby having sanctioned an extreme departure by the federal district court from established federal and state securities laws?

3. Was it proper for the federal court of appeals to affirm the federal district court's creation of its own "law" and failure to apply any previously-existing statutory or case law to the alleged state securities causes of action?

4. Was it proper for the federal court of appeals to fail to exercise its supervisory power by allowing the federal district court to find facts having no support whatsoever in the evidence adduced, and which were actually contrary to the evidence adduced, and then to use those determined "facts" as the basis for its decision?

5. Did the federal court of appeals err by affirming that the district court could impose the burden of proof for

establishing a state securities transactional exemption on Petitioners, where state law clearly imposes that burden on Respondents, and to then hold that Petitioners did not meet their burden of proof when in fact Respondents did not meet their burden of proof?

6. Did the federal court of appeals err by affirming the federal district court's determination that where oil and gas working interests for shallow wells are sold to investors such as Petitioners, geological data does not constitute a "material fact," and therefore Respondents, as sellers of such interests, did not omit to disclose a material fact within the scope of the anti-fraud provisions of the federal securities laws when they admittedly failed to disclose any geological data to Petitioners?

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OFFICIAL REPORT OF OPINION DELIVERED IN THE COURT BELOW

Cowles v. Dow Keith Oil & Gas, Inc., 752 F.2d 508 (10th Cir. 1985).

The Petitioners, R.S. Cowles and Gloria B. Cowles, respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Tenth Circuit entered on January 16, 1985, rehearing of which was denied on February 10, 1986.

JURISDICTION

The date of the judgment of the United States Court of Appeals for the Tenth Circuit sought to be reviewed is January 16, 1985.

The date of the order of the United States Court of Appeals for the Tenth Circuit denying Petitioners' petition for rehearing with suggestion of rehearing en banc is February 10, 1986.

The jurisdiction of this Court is invoked under Title 28, United States Code, Section 1651(a).

FEDERAL AND STATE STATUTES INVOLVED

15 U.S.C. §78j(b). Manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange --

> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

15 U.S.C. §771(2). Civil liabilities arising in connection with prospectuses and communications.

Any person who --

> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they are made, not misleading (the purchaser

not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

17 C.F.R. §240.10b-5. Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

71 Okla. Stat. §201(a) and (b). Registration requirement.

> (a) It is unlawful for any person to transact business in this state as a broker-dealer or agent unless he is registered under this act.
>
> (b) It is unlawful for any broker-dealer or issuer to employ an agent unless the agent is registered. The registration of an agent is not effective during any period when he is not associated with a particular broker-dealer registered under this act or a particular issuer. When an agent begins or terminates a connection with a broker-dealer or issuer, or begins or terminates those activities which make him an agent, the agent as well as the broker-dealer or issuer shall promptly notify the Administrator.

71 Okla. Stat. §301. Registration requirement.

It is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 401.

71 Okla. Stat. §401(e). Exemptions.

> (e) In any proceeding pursuant to the provisions of the Oklahoma Securities Act, the burden of proving an exemption or an exception from a definition is upon the person claiming it.

71 Okla. Stat. §401(b)(15). Exemptions.

> (b) The following transactions are exempted from Sections 301 and 402 of this title:

(15) A. Any sale from or in this state to not more than thirty-two persons of a unit consisting of interests in oil, gas or mining titles or leases or any certificate of interest or participation, or conveyance in any form of an interest therein, or in payments out of production pursuant to such titles or leases, whether or not offered in conjunction with, or as an incident to, an operating agreement or other contract to drill oil or gas wells or otherwise exploit the minerals on the particular leases, whether or not the seller or any purchasers are then present in the state, if:

1. the seller reasonably believes that all buyers are purchasing for investment;

2. no commission is paid or given directly or indirectly for the solicitation of any such sale excluding any commission paid or given by and between parties each of whom is engaged in the business of exploring for or producing oil and gas or other valuable minerals;

3. no public advertising or public solicitation is used in any such solicitation or sale; and

4. sales are effected only to persons the seller has reasonable cause to believe are capable of evaluating the risk of the

prospective investment and able to bear the economic risk of the investment; but the Administrator, by rule or order, as to any specific transaction, may withdraw or further condition this exemption or decrease the number of sales permitted or waive the conditions in divisions, 1, 2 and 3, with or without substitution of a limitation on remuneration.

B. For the purpose of the foregoing transactional exemption, no units by the issuer or associates shall be integrated, however this exemption cannot be combined or used in conjunction with any other transactional exemption.

71 Okla. Stat. §408(a)(1) and (2). Civil liabilities.

(a) Any person who --

(1) offers or sells a security in violation of Sections 201(a), 301, or 404(b) of this title, or of any rule or order under Section 402 which requires the affirmative approval of sales literature before it is used, or of any condition imposed under Sections 304(d), 305(g), or 305(h) of this title, or

(2) offers or sells or purchases a security by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light

of the circumstances under which they are made, not misleading (the other party not knowing of the untruth or omission), and who does not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of the untruth or omission, is liable:

(i) in the case of an offer or sale of a security by such means, to the person buying the security from him, who may sue either at law or in equity to recover the consideration paid for the security, together with interest at ten percent (10%) per year from the date of payment, costs, and reasonable attorneys' fees, less the amount of any income received on the security, upon the tender of the security, or for damages if he no longer owns the security. Damages are the amount that would be recoverable upon a tender, less the value of the security when the buyer disposed of it, and interest at ten percent (10%) per year from the date of disposition,

(ii) in the case of a purchase of a security by such means, to the person selling the security to him, who may sue at law or equity, for a return of the security, together with any income received by the purchase on the security, costs and reasonable attorneys' fees, upon a tender of the full amount of the consideration received for

> the security, or, if the purchaser no longer owns the security, for the difference between the fair value of the security at the date of the transaction and the consideration received for the security, together with interest on such difference at the rate of ten percent (10%) per year from the date of the transaction, costs and reasonable attorneys' fees.

STATEMENT OF THE CASE

Procedural History

This action was initiated by Petitioners against Respondents for alleged violations of state and federal securities acts, breach of contract and conversion arising out of the sale of oil and gas working interests by the Respondents to the Petitioners. Petitioners initiated this suit in the court of first instance, the U.S. District Court for the Western District of Oklahoma, basing federal jurisdiction under the provisions of Section 22(a) of the Securities Act of 1933, 15 U.S.C. §77v(a), Section 27 of the Securities

Exchange Act of 1934, 15 U.S.C. §78aa, and pendent jurisdiction of the state claims.

Judgment was rendered in favor of Respondents by the district court following a non-jury trial. Findings of Facts and Conclusions of Law were issued by the district court. Following denial of Petitioners' Motion to Amend Findings and Make Additional Findings or in the Alternative Motion to Alter or Amend the Judgment of the Court, or in the Alternative Motion for New Trial, Petitioners appealed to the United States Court of Appeals for the Tenth Circuit. A three-judge panel affirmed the judgment of the district court by a 2-1 decision. Judge Barrett wrote the majority opinion, with a dissenting opinion written by Judge McKay. The entire slip opinion was published. Petitioners filed a Petition for Rehearing Accompanied by Suggestion for En Banc Consideration, which was denied on February 10, 1986.

Facts Material to Consideration of the Questions Presented

Petitioners, residents of Oklahoma, purchased fractional oil and gas working interests in three leases from Respondent Dow Keith Oil & Gas, Inc., an Oklahoma corporation having its principal place of business in Lawton, Oklahoma ("Keith Corp."), and operated by Dow Keith, an Oklahoma resident ("Keith"). The leases all covered tracts located in Comanche County, Oklahoma. The interests were securities within the meaning of the Federal Securities Act of 1933, the Federal Securities Exchange Act of 1934, and the Oklahoma Securities Act. At the times the securities were sold to Petitioners, the securities were not registered with the Federal Securities and Exchange Commission nor with the Oklahoma Securities Commission. Keith Corp. was the issuer of the securities, and Keith individually was

a "control person" with respect to the sales of the securities.

Keith Corp. used the mails and the telephone system to sell the working interests. Some sales were made to persons outside the State of Oklahoma. Keith admittedly did not even speak to some of the investors, but simply accepted their funds and sent them operating and letter agreements. He transacted all of the securities sales and made no effort to ascertain that any investor was capable of evaluating the risk of investment or that any investor could bear the economic risk.

No prospectus was provided to Petitioners or any other investor. They received only a three-page "operating agreement" and a two-page "letter agreement" for each lease, stating their interest in the lease and proportionate cost for drilling and completing wells on the premises subject to the lease, and

stating that they acknowledged that the investment involved a risk.

No geological data of any kind was provided to Petitioners. Petitioners were unsophisticated investors in oil and gas ventures and relied on the representations of Keith and Keith Corp. Keith represented that he had experience and expertise in the oil and gas industry, when in fact he had very little experience. He also misrepresented the performance and expectations of particular wells. No authorization for expenditures ("A.F.E.") was prepared by Keith or Keith Corp. with regard to any of the wells.

Petitioners invested a total of $48,700.00 in the three working interests. Two of them were acquired by Petitioner R.S. Cowles and the other was acquired by Petitioners R.S. Cowles and Gloria B. Cowles as joint tenants.

In the letter agreements for two of the three investments, Keith Corp. represented that investor funds would be used for various purposes, including geology, surveys and engineering. Much of that work was admittedly never performed. The evidence also established that the drilling and completion costs charged were excessive.

Petitioners tendered their securities back to Keith Corp., which refused to accept them, and then brought suit in the United States District Court for the Western District of Oklahoma, alleging violations of federal and Oklahoma securities laws, common law fraud (which was dropped prior to trial), breach of contract, and conversion.

ARGUMENT IN SUPPORT OF ALLOWANCE OF WRIT

In this case, the federal district court committed errors of startling

magnitude. It ignored much of the uncontradicted evidence to arrive at its own version of the "facts." It imposed a burden of proof on Petitioners which clearly fell on Respondents. It usurped the federal securities laws by holding that there was no material fact to be disclosed by Respondents as sellers of the securities (fractional working interests in oil and gas leases) to Petitioners as buyers of those securities. It emasculated the Oklahoma securities laws by "legislating" a transactional exemption which does not exist within the statutory framework. It also found Respondents not liable for breaching contracts which the evidence clearly showed had occurred.

The federal court of appeals inexplicably magnified those errors by affirming the district court in a 2-1 panel decision. Petitioners sought rehearing, which was supported by a brief amicus curiae

of the Oklahoma Securities Commission, stating that the federal appeals court's decision only provides promoters with a subterfuge under which they can be remiss in their duties to investors, a result inconsistent with established case law and contrary to legislative intent. Rehearing was denied, leading to the filing of this petition.

As stated above, the federal district court has "legislated" an Oklahoma securities exemption which does not exist. The Oklahoma securities exemption claimed by Respondents, 71 Okla. Stat. (1981) §401(b)(15), was clearly not met.

That statute, which applies to sales of oil and gas working interests, requires that the seller reasonably believe that all buyers are purchasing for investment, and that sales be made only to persons the seller has reasonable cause to believe are capable of evaluating the risk of the

investment and are able to bear the economic risk. Oklahoma law clearly requires that Respondents, as sellers of the securites, prove all elements of the claimed exemption as to each and every investor. Lambrecht v. Bartlett, 656 P.2d 269 (Okla. 1982).

Here, Keith, the sole seller of the securities, admitted that there were investors to whom he did not even speak. His only evidence to attempt to show that the exemption was met consisted of his own testimony that the investors contacted him and purchased the securities for cash. As the Honorable Monroe McKay, Circuit Judge of the United States Tenth Circuit Court of Appeals, correctly pointed out in his dissenting opinion in this case, "[i]f this kind of testimony alone could establish the exemption, the registration requirements of the [Oklahoma Securities] Act would be emasculated. In view of the way this exemption has been treated by the Oklahoma

cases, I do not believe we can properly treat this as sufficient evidence on these two critical issues."

There was absolutely no evidence that Respondents had any cause to believe that each investor was purchasing for investment, could evaluate the risk of the investment, and could bear the economic risk. As Judge McKay noted, Respondents had to prove those elements, and "[t]heir evidence simply did not meet this burden. Indeed, Mr. Keith admitted that he had not even spoken with some of the investors."

The federal district court was apparently swayed not by the law, but by its view that Keith was unsophisticated, was drilling shallow wells, and had no better means of acquiring relevant geological data than did the investors. That is not relevant to the securities laws violations presented. As Judge McKay further stated in his dissenting opinion,

"[i]t is apparent that what impressed the court was not the sophistication of the investors but rather the lack of sophistication of the sellers of the securities. There is nothing in the Oklahoma cases to suggest that this criterion has any bearing on the determination of whether the very limited [§]401(b)(15) exemption is available." In fact, the primary public policy for the enactment of securities laws, and the legislative intent behind the enactment of the Oklahoma Securities Act, was to protect the public because of their lack of knowledge and sophistication about securities investment, regardless of the sophistication of the seller of the securities.

Indeed, the decision in this case has since been referred to by seminar commentators as creating a "new 1000-foot-well-pay-for-in-cash

exemption." It has no basis in the securities laws. Professor Joseph C. Long, President of the North American Securities Administrators Association, Inc., discusses the "investment intent" requirement in his treatise, Blue Sky Law (Clark Boardman Co., Ltd., 1985), p. 5-58, stating that "it is difficult to see how the seller could establish the requisite intent on the purchaser's part if the matter is not discussed." He then describes the federal court of appeals' decision in this case as "a horrible aberration."

The courts do not have the authority to legislate. Here, the federal district court has violated the fundamental doctrine of separation of powers. It ignored the clear requirements of the statute and created its own exemption. Such action will not be condoned by this Court. Keller v. Potomac Electric Power Co., 261 U.S. 428 (1923).

It is also clear, under both federal and Oklahoma securities laws, that whether the seller contacts the buyer or vice versa is immaterial to the application of those laws. Here, however, the federal district court determined, as did the federal court of appeals, that the investors contacted the seller, rather than the reverse, hence "this is not a typical securities fraud case. . ." Slip Opinion, p. 6.

Section 401(b)(15) also requires that a seller claiming that exemption must prove that he/she received no commission or other remuneration directly or indirectly for the solicitation of any such sale (with an exception for sales to persons engaged in the oil and gas business, which is not applicable here). The evidence showed that Respondents' charges for drilling and completion were excessive, and Respondents did not rebut that evidence. Oklahoma law is clear that excessive charges for drilling

and completion are considered to be commissions or other remuneration which, where they exist, prohibit qualification by the seller for application of the exemption. Petroleum Research Development Corp. v. State ex rel. Day, 585 P.2d 346 (Okla. 1978).

The federal district court misapprehended the facts in that respect by confusing drilling and completion charges with operating expenses. Petitioners had also alleged that monthly working interest operating expenses charged to them were excessive, as part of their breach of contract claim. Those operating charges were totally separate and distinct from the "front-end" drilling and later completion charges. The excessive monthly operating charges were found by the court to have been corrected in subsequent monthly billings, but that conclusion had nothing

to do with the excessive drilling and completion charges.

The federal court of appeals then compounded this obvious error by finding (Slip Opinion, p. 7) that the excessive monthly operating charges were corrected when discovered and thus were not "disguised commissions." Neither court ever addressed the true issue, which was that excessive drilling and completion costs were charged, which were clearly "commissions or other remuneration."

The federal district court and federal court of appeals also ignored the evidence with respect to Petitioners' claim that Respondents' failure to disclose any geological data constituted an omission to disclose a "material fact" within the purview of 15 U.S.C. §78j(b) and SEC Rule 10b-5 thereunder (17 C.F.R. §240.10b-5). The federal district court held that Respondents' failure to disclose such data

was excusable because Keith was a "very small operator who conducts a minor operation in drilling shallow wells" and because Petitioners "had about as much means of acquiring information and knowledge as did the defendant[s]." Findings of Fact and Conclusions of Law, pp. 3-4. There is no basis in the federal or Oklahoma securities laws for finding that the size or economics of an operation involving securities excuses the failure of the seller to disclose any information or that the unsophisticated investor is not to be protected under those laws from the unsophisticated seller.

The evidence showed, without contradiction, that geological data is material even with respect to investment in a smaller oil and gas venture. Uncontradicted expert testimony established that Respondents' operation was "haphazard at best." R., p. 179. This

Court has held that a fact would be deemed "material" under 15 U.S.C. §78j(b) if there was a substantial likelihood that a reasonable person would consider it important in deciding whether to purchase the offered security. T.S.C. Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976). Here, the evidence showed indisputably that at least some geological data would be considered important by a person deciding whether to invest in an oil and gas venture, but it was admitted by Respondents that no such data was furnished to Petitioners.

The decisions of the federal district court and the federal court of appeals in this case are totally incomprehensible in view of the evidence and the laws. The district court was apparently moved to construct a set of "facts" and a "law" in order to find for Respondents. The appeals court failed to discharge its burden of overlooking the numerous and obvious errors

of the district court. Petitioners brought those errors to the attention of the federal court of appeals, and with respect to the Oklahoma securities laws violations, the Oklahoma Securities Commission supported Petitioners' position. The appeals court seems to have been asleep at the wheel, resulting in a decision having no basis under the federal and Oklahoma securities laws and creating completely improper "judicial legislation."

While the unwarranted effect of the decision on sellers and buyers of oil and gas working interests, as well as perhaps other securities, is important, an even more serious issue is presented with respect to the role of the courts. The courts do not have the power to create facts nor to ignore uncontraverted evidence. More importantly, they do not have the power to legislate. Public reliance on the judicial system is in serious jeopardy when the

courts unexplainably venture into territory in which they are prohibited to go by fundamental constitutional postulates.

The courts' role is to enforce and uphold the law, not to create it. The courts cannot create common law substitutes for clearly-drafted statutes. If the decision of the federal court of appeals in this case is not reversed, there will remain not only an extreme departure from existing securities laws but also a serious deviation by the judiciary branch into the legislative role.

This Court should review the federal court of appeals' decision for all of those reasons. The federal court of appeals' decision <u>is</u> a "horrible aberration" resulting in a serious injustice, which this Court should not tolerate.

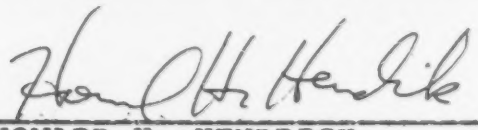
The district court's errors are obvious. The federal court of appeals failed to properly review the district

court's decision, thereby sanctioning a maverick departure from the law by the district court for which there was and is absolutely no justification. This Court should therefore excerise its supervisory power over the federal court of appeals and reverse that court's decision.

CONCLUSION

For the foregoing reasons, Petitioners respectfully request that a Writ of Certiorari issue from this Court to review the judgment of the United States Court of Appeals for the Tenth Circuit.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of May, 1986, three copies of the above and foregoing Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit, and one copy of above counsels' Entry of Appearance were mailed, with postage fully prepaid postage thereon, by first class mail, and properly addressed, to:

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APPENDIX DIRECTORY

Appendix A: Slip Opinion, United States Court of Appeals Tenth Circuit

Appendix B: Judgment of the United States District Court for the Western District of Oklahoma

Appendix C: Findings of Fact and Conclusions of Law of the United States District Court for the Western District of Oklahoma

Appendix D: Order Denying Petition for Rehearing, United States Court of Appeals Tenth Circuit

APPENDIX A

SLIP OPINION

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

R. S. COWLES and GLORIA B. COWLES, Plaintiffs-Appellants,	)	
v.	)	No. 83-1464
DOW KEITH OIL & GAS, INC., an Oklahoma corporation, and DOW KEITH, Individually Defendants-Appellees.	)	

Appeal from the United States District Court For the Western District of Oklahoma (D.C. No. CIV-82-1259)

Submitted on the briefs:

Michael W. Thom and Jimanne H. Mays of Speck, Philbin, Fleig, Trudgeon & Lutz, Oklahoma City, Oklahoma, for Appellants.

Robert W. Pittman, Oklahoma City, Oklahoma, for Appellees.

Before BARRETT, DOYLE and McKAY, Circuit Judges.

BARRETT, Circuit Judge.

After examining the briefs and the appellate record, this three-judge panel has determined unanimously that oral argument would not be of material assistance in the determination of this appeal. See Fed. R. App. P. 34(a); Tenth Circuit R. 10(e). The cause is therefore ordered submitted without oral argument.

This action was initiated by Appellants, R. S. Cowles and Gloria B. Cowles (the Cowles), against Appellees, Dow Keith and Dow Keith Oil & Gas, Inc. (Dow Keith Corp.), for alleged violations of state and federal securities acts, breach of contract, and conversion arising out of the sale to the Cowles of working interests in oil and gas wells located in Oklahoma. From a judgment entered in favor of Dow Keith and Dow Keith Corp. following a nonjury trial, the Cowles appeal.

Most of the facts relevant to this appeal were stipulated to by the parties

and incorporated into the district court's Findings of Fact and Conclusions of Law. Those facts will be briefly summarized.

In 1980 and 1981, the Cowles purchased fractional, or "working," interests from Dow Keith Corp. in three oil and gas leases: the Fuqua lease; the Gibbs lease; and the Smith lease. These interests constitute "securities" as defined in the Oklahoma Securities Act (OSA), the Federal Securities Act of 1933 (FSA), and the Federal Securities Exchange Act of 1934 (FSEA). These interests were not, however, ever registered with either the Oklahoma Securities Commission or the Federal Securities Exchange Commission. Also, neither Dow Keith nor Dow Keith Corp. was registered at the time these interests were sold to the Cowles in any capacity--broker, agent, or otherwise--with either the Oklahoma Securities Commission or the Federal Securities and Exchange Commission.

Dow Keith Corp. was the "issuer" of the securities sold to the Cowles and Dow Keith was a "control person" with regard to such sales as those terms are defined in the OSA, the FSA, and the FSEA.

Neither Dow Keith nor Dow Keith Corp. ever performed or obtained any geological studies with respect to wells drilled or to be drilled on these leases. Consequently, investors, including the Cowles, were never provided any geological data with regard to these wells. Some of the investors in these leases resided outside the State of Oklahoma at the time they purchased fractional interests, and both the mails and the telephone system were used in the sale of working interests in the Fuqua, Smith and Gibbs leases.

Based on these facts and others that will be developed, the Cowles brought suit against Dow Keith and Dow Keith Corp. alleging violations of Section 10(b) of the

Securities Exchange Act of 1934, as amended, 15 U.S.C. § 78j(b) (1976), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.106-5; Section 12(2) of the Securities Act of 1933, as amended, 15 U.S.C. § 771(2) (1976); Sections 408(a)(1) and 408(a)(2) of the Oklahoma Securities Act, 71 Okla. Stat. § 408 (1983); breach of contract; and conversion. The district court found that the Cowles had not sustained their burden of proof under either of the Securities Acts. It also resolved the breach of contract and conversion claims against the Cowles.

On appeal, the Cowles challenge a number of the district court's findings. It will, therefore, be instructive for us to set forth the standards to be employed when reviewing such findings. An appellate court must view the evidence adduced in the trial court in the light most favorable to the prevailing party. Joyce v. Davis, 539

F.2d 1262, 1264 (10th Cir. 1976). Where trial is to the court, as it was here, the resolution of factual issues and conflicting evidence lies solely within the province of the district court. Harmon City, Inc. v. United States, 733 F.2d 1381, 1385 (10th Cir. 1984). Such findings, even when they involve expert testimony, are presumptively correct and should not be set aside on appeal unless they are clearly erroneous. Colon-Sanchez v. Marsh, 733 F.2d 78, 80-81 (10th Cir. 1984). A finding of fact is "clearly erroneous" if it is without factual support in the record, Farmers & Bankers Life Ins. Co. v. Allingham, 457 F.2d 21, 24 (10th Cir. 1972), or if the appellate court, after reviewing all the evidence, is left with a definite and firm conviction that a mistake has been made. Clancy v. First Nat'l Bank of Colorado Springs, 408 F.2d 899, 903 (10th Cir. 1969), cert. denied, 396 U.S. 958 (1969).

The Cowles maintain that the district court erred in finding that the fractional interests (securities) sold to them by Dow Keith Corp. were exempted from the registration requirements of OSA.[1] Specifically, they contend that Dow Keith and Dow Keith Corp. did not satisfy each of the elements of 71 Okla. Stat. Ann. § 401(b)(15) (1983)[2] as to each investor

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1 71 Okla. Stat. Ann. § 301 (1965) provides:

> "It is unlawful for any person to offer or sell any security in this state unless (1) it is registered under this act or (2) the security or transaction is exempted under section 4a.

2 (15) A. Any sale from or in this state to not more than thirty-two persons of a unit consisting of interests in oil, gas or mining titles or leases or any certificate of interest or participation, or conveyance in any form of an interest therein, or in payments out of production pursuant to such titles or leases, whether or not offered in conjunction with, or as an incident to, an operating agreement or other contract to drill oil or gas wells or otherwise exploit the minerals on the particular leases, whether or not the seller or any purchasers are then present in the state, if:

in the Fuqua, Smith, and Gibbs leases. While it is true that establishing an exemption is an affirmative defense under Oklahoma law, State v. Hoephner, 574 P.2d 1079, 1081 (Okl. Cr. 1978), the district court found, as the Cowles concede,

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1. the seller reasonably believes that all buyers are purchasing for investment;

2. no commission or other remuneration is paid or given directly or indirectly for the solicitation of any such sale excluding any commission or remuneration paid or given by and between parties each of whom is engaged in the business of exploring for or producing oil and gas or other valuable minerals;

3. no public advertising or public solicitation is used in any such solicitation or sale; and

4. sales are effected only to persons the seller has reasonable cause to believe are capable of evaluating the risk of the prospective investment and able to bear the economic risk of the investment; but the Administrator, by rule or order, as to any specific transaction, may withdraw or further condition this exemption or decrease the number of sales permitted or waive the conditions in divisions 1, 2 and 3, with or without substitution of a limitation on remuneration.

that Dow Keith and Dow Keith Corp. had brought themselves within § 401(b)(15). Therefore, we cannot disturb the district court's finding unless it is clearly erroneous.

The Cowles' argument apparently is that the district court's finding that the sales of working interests were exempt was clearly erroneous because § 401(b)(15)A 1, 2, and 4 were not sufficiently established. The Cowles contend subsections 1 and 4 were not satisfied because Dow Keith and Dow Keith Corp. did not prove they reasonably believed each buyer was purchasing for investment and that each buyer was capable of evaluating and able to bear the risks of the investment. We disagree. As the district court recognized, this is not a typical securities fraud case in that the Cowles and the other investors initially contacted Dow Keith seeking to invest, rather than the reverse. Finding of Fact

#16. Several of the investors, including the Cowles, learned about Dow Keith and his operations from Mr. Cowles' dentist, Dr. Ralph Shadid, who already was one of Dow Keith's investors when the Cowles learned of Dow Keith's operations. R. Vol. IV at 20-21; 121-127. These facts, together with the following testimony of Dow Keith on cross-examination, convince us that Dow Keith could reasonably have believed the buyers were purchasing for investment and were able to evaluate and bear financially the risks of those investments:

Q (Mr. Pittman): Have you ever sold any of these interests by installment?

A (Dow Keith): No.

Q So that . . .

A You're talking about installment over a period of months?

Q Yes.

A No.

Q So that you did have an indication from all of these people that they had the cash to pay for the interests that they wanted to buy.

A I did.

Id. at 157.

The Cowles argue that § 401(b)(15)A 2 was also not established by Dow Keith and Dow Keith Corp. It was admitted that costs charged by Dow Keith and Dow Keith Corp. to drill and complete certain wells were excessive. The Cowles contend these overcharges were disguised commissions. The district court found, and based on our review of the record we agree, that these overcharges "were inadvertent and unintentional and were corrected when discovered and resulted in no damage to the [Cowles]." Finding of Fact #21. As such, they were not "disguised commissions" as alleged by the Cowles. Consequently, we hold that the district court's finding that

the sales of working interests here involved were exempt from registration under OSA was not clearly erroneous.

For similar reasons, we agree with the district court's finding that there was no public offering triggering the registration requirements of the Federal Securities Acts. In G. Eugene England Found. v. First Fed. Corp., 663 F.2d 988, 990 (10th Cir. 1973), this Court stated that "[i]n determining what constitutes a public offering, . . . 'the general criterion is whether the particular persons affected stand in need of the protection of the Act,'" quoting Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963). As noted above, the district court found this not to be a typical securities case because the investors contacted Dow Keith initially. The district court further found that, because Dow Keith conducted "a minor operation" drilling only "shallow wells,"

the Cowles "had about as much means of acquiring information and knowledge as did the defendant." Finding of Fact #18. We believe there is ample support for these findings in the record. Thus, we agree that the Cowles were not persons in need of the protections of the Securities Acts. Consequently, we hold that the district court's finding that there was no public offering was not clearly erroneous.

As noted earlier, Dow Keith and Dow Keith Corp. did not provide any of the investors, including the Cowles, any geological or similar data with respect to wells drilled or to be drilled on the leases involved here. The Cowles contend that failure to provide such information constitutes omission of a "material fact" in violation of Rule 10b-5, 17 C.F.R. § 240.10b-5. The district court found, and we agree, however, that although geological and similar data might be "material" if Dow

Keith were a "big operator drilling deeper holes," such information was not material under the facts of this case. Involved here was a small operator conducting a minor operation in the drilling of shallow--approximately one thousand feet deep--wells. Though the Cowles may have been unsophisticated, they had, as the district court found, "about as much means of acquiring information and knowledge as did [Dow Keith]." Finding of Fact #18. The district court's finding that failure to provide geological and similar information was not the omission of a "material fact" was not, therefore, clearly erroneous.

The Cowles assert that the district court erred in determining that no fraud, misrepresentation or deception was employed by Dow Keith and/or Dow Keith Corp. in inducing the Cowles to purchase interests in the leases. Brief of Appellants at 33.

Specifically, they state that "[n]o testimony was adduced by the counsel of Keith Corp. that there was no intent by Keith Corp. or Keith to defraud their investors." Id. at 36. They apparently would have us overlook, however, the following testimony of Dow Keith on cross-examination:

> Q (Mr. Pittman): Have you ever told anyone that a lease or a prospective well was a lead cinch or a lead-pipe cinch?
>
> A (Mr. Dow Keith): There ain't one of them, no.
>
> Q Have you ever told anyone there is?
>
> A Not in that sense, no.
>
> Q Have you ever told people that all indications are that there is some oil down there and that we can drill and see what we can produce?

A I have told them that there should be some oil down there, and whether it would be feasible for us or not; that we would have to drill and see. You never know until you drill them.

Q Do you feel that you have misled or lied to your investors in any way in regard to these three leases?

A No, sir.

Q Did they have all of the information to make their decision that you had to make your decision to be the primary corporation in the corporation making its decision?

A Yes. They knew just about everything I did.

R. Vol. IV at 128-129. We hold that the district court did not err in concluding that no fraud, misrepresentation, or deception was employed by Dow Keith and/or Dow Keith Corp.

The Cowles contend that Dow Keith and Dow Keith Corp. breached their operating

agreement "by acting arbitrarily and capriciously and failing to exercise their discretion and good faith" in deciding to complete two Gibbs wells. Brief of Appellants at 18. In deciding to complete these wells, Dow Keith testified that he "relied on a lot of people," including engineers. R. Vol. IV at 98. He relied on core samples as well as electrical logs, which measure the thickness of potential producing zones, in deciding whether to complete the wells. Id. at 96-101. Based on this information, the district court found, and we agree, that completion of the Gibbs wells "was a reasonable business venture, and although it did not pay out, the defendant could, and likely would, have been soundly criticized had he not completed these two wells." Finding of Fact #22.

Finally, the Cowles claim that Dow Keith's removal of the pumpjack and set pipe from the Smith #2 well to the Smith

was "poor business judgment" for Dow Keith to move equipment from one well to another, still no conversion occurred because he did not intend to harm anyone but instead did "what he believed would be helpful to everyone in saving costs." Finding of Fact #19.

Nonetheless, even assuming that Dow Keith's removal of the pumpjack and tubing was somehow "illegal" or "wrongful," still the Cowles' conversion claim must fail because, by Mr. Cowles' testimony, he was not damaged by such removal, See Benton v. Ortenberger, 371 P.2d 715, 717 (Okla. 1962) (Plaintiff in conversion action has burden of proving "the damages sustained by him"). Cowles testified:

> Q (Mr. Pittman): What do you claim you lost, if anything, as the result of the pump being moved from the Smith 2 to the Smith 4?

A (Mr. Cowles): What is the future of the Smith 2? You know, as far as I was concerned, it was making as much oil as the Smith 4 is now. Within $20 of the same amount.

Q You're saying that your income increased $20 per month by moving the pump from the Smith 2 to the 4?

A Yes.

Q So that you didn't lose; you gained.

A No. But I have been billed, and he says I owe him $1700 or whatever it costed to move it. He billed me for $1700 or a part of the Smith 4. He shut down the one that I had already paid for part of.

Q But you have told him you are not going to pay, and that you're not going to participate in the Smith 4.

A Right.

Q So you haven't been out that $1750.

A Well, but I have been out whatever the production is on the Smith 2.

Q But you said the production was less than the production on the 4.

A Right.

Q Which you're sharing in.

A Right.

R. Vol. IV at 60-61.

AFFIRMED.

McKAY, Circuit Judge, dissenting:

The question in this case is straightforward. Is there sufficient evidence in the record to establish that defendants, sellers of securities who claim an exemption from securities registration requirements under 71 Okla. Stat. Ann. § 401(b)(15), have carried their burden of proving that each and every investor was capable of evaluating the risk of the investment and that each and every investor was capable of bearing the economic risk

of the investment. The evidence offered on this point consisted exclusively of Mr. Keith's testimony that all the investors initially contacted him, on the advice of friends, seeking to invest, and that none of the securities were sold on installment. If this kind of testimony alone could establish the exemption, the registration requirements of the Act would be emasculated. In view of the way this exemption has been treated by the Oklahoma cases, I do not believe we can properly treat this as sufficient evidence on these two critical issues. See Lambrecht v. Bartlett, 656 P.2d 269 (Okla. 1982), and Parrish v. Ben-Jon Oil Co., 666 P.2d 1308 (Okla. Ct. App. 1983).

The defendants in this case had the burden of proving all elements of the claimed exemption, including the sophistication of each investor. Parrish, 666 P.2d at 1309; Lambrecht, 656 P.2d at

272. Their evidence simply did not meet this burden. Indeed, Mr. Keith admitted that he had not even spoken with some of the investors. Record, vol. 4, at 148-50. After examining the decision of the trial court, it is apparent that what impressed the court was not the sophistication of the investors but rather the lack of sophistication of the sellers of the securities. There is nothing in the Oklahoma cases to suggest that this criterion has any bearing on the determination of whether the very limited 401(b)(15) exemption is available.

I would reverse the decision of the trial court.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

R. S. COWLES and GLORIA B. COWLES,	)	
Plaintiffs,	)	
v.	)	No. CIV-82-1259
DOW KEITH OIL & GAS, INC., an Oklahoma corporation, and DOW KEITH, individually,	)	
Defendants.	)	

JUDGMENT

Based upon the Findings of Fact and Conclusions of Law filed herein on this date, judgment is hereby entered in favor of the defendants and against the plaintiffs so that plaintiffs take nothing by reason of their complaint filed herein and that the defendants recover their costs herein expended.

The Clerk of the Court will mail copies hereof to counsel of record.

DATED this 9th day of February, 1983.

/s/ Luther B. Eubanks
LUTHER B. EUBANKS
United States District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT FOR THE

WESTERN DISTRICT OF OKLAHOMA

R. S. COWLES and GLORIA B. COWLES,	)	
Plaintiffs,	)	
v.	)	No. CIV-82-1259
DOW KEITH OIL & GAS, INC., an Oklahoma corporation, and DOW KEITH, individually,	)	
Defendants.	)	

Michael W. Thom and Jimanne H. Mays of Speck, Philbin, Fleig, Trudgeon & Lutz, 800 City National Bank Tower, Oklahoma City, Oklahoma 73102, for Plaintiffs

Robert W. Pittman, 2250 N.W. 39th Street, Suite 103, Oklahoma City, Oklahoma 73112, for Defendants.

FINDINGS OF FACT

AND

CONCLUSIONS OF LAW

Before LUTHER B. EUBANKS, United States District Judge

Findings of Fact

In this non-jury case some of the relevant facts have been agreed to and an evidentiary hearing was conducted with respect to those facts that the parties could not agree to.

Those matters which the parties have resolved by written stipulation are as follows:

1. The interests purchased by plaintiffs from Dow Keith Oil & Gas, Inc., as represented by the operating agreements and letter agreement attached as exhibits to plaintiffs' petition herein, are fractional interests in oil and gas leases and constitute "securities" within the meaning of that term in the Oklahoma Securities Act, the Federal Securities Act of 1933, and the Federal Securities Exchange Act of 1934.

2. The securities have never been registered with, and were not at the respective times of the sale to plaintiffs thereof registered with, the Oklahoma Securities Commission nor the Federal Securities and Exchange Commission.

3. Neither Dow Keith Oil & Gas, Inc., nor Dow Keith were, at the times of the respective sales of the securities to plaintiffs, registered in any capacity, as "broker-dealer", "agent", or otherwise, with the Oklahoma Securities Commission nor the Federal Securities and Exchange Commission.

4. Dow Keith and Dow Keith Oil & Gas, Inc. used the mails and the telephone system with regard to transactions involving sales or distribution of documents relating to the sales of the working interests in the Fuqua, Smith, and Biggs leases to the various purchasers thereof.

5. Dow Keith Oil & Gas, Inc. was the "issuer" of the securities.

6. Dow Keith, individually, was a "control person" with regard to the sales of the securities made by Dow Keith Oil & Gas, Inc., as that term is used in the Oklahoma Securities Act, the Federal Securities Act of 1933, and the Federal Securities Exchange Act of 1934.

7. Dow Keith Oil & Gas, Inc. sold some of the securities as to each of the Fuqua, Smith, and Gibbs leases to investors who reside outside the State of Oklahoma.

8. Neither Dow Keith Oil & Gas, Inc. nor Dow Keith performed any geological studies nor obtained any such studies with respect to the wells drilled or to be drilled by Dow Keith Oil & Gas, Inc. on the Fuqua, Smith, and Gibbs leases.

9. Dow Keith Oil & Gas, Inc. and Dow Keith, individually, omitted to provide any geological data to the investors in the

securities which were working interests in the Fuqua, Gibbs, and Smith leases.

10. Dow Keith Oil & Gas, Inc. allowed a lien to attach to the Smith lease and working interests on March 22, 1982, in favor of Serv-A-Well, in violation of Paragraph 3 of the Smith operating agreement, which lien was not released until April 7, 1982.

11. Dow Keith Oil & Gas, Inc. and/or Dow Keith removed the pump and set pipe from the Smith #2 well without notifying plaintiffs of his intention to do so nor his actually having done so, and transferred same to the Smith #4 well.

12. Dow Keith Oil & Gas, Inc. has only one tank battery for all of the Smith wells, including the Smith #4 well; therefore, plaintiffs have been receiving a part of the production from the Smith #4 well.

13. Plaintiffs have complied with all requirements in the securities laws above mentioned as to tender of their securities to defendants.

14. Plaintiffs have agreed to and hereby do dismiss Counts Five and Six of their petition filed herein.

15. The operating agreements and letter agreements attached to plaintiffs' petition are true and correct copies of the originals thereof.

The following facts, although not stipulated, are supported by the evidence:

16. This is not a typical securities case wherein information is withheld by a sophisticated operator from an unsophisticated investor. The plaintiffs were not solicited by defendant but learned of the operation conducted by the defendant through Dr. Shadid, who himself was an investor with the defendant. Thereafter, the plaintiffs contacted the defendant

rather than the reverse, which is the usual situation in such matters.

17. Defendant, Dow Keith, is a very small operator who conducts a minor operation in drilling shallow wells. He does not employ geologists and the court finds this type of operation does not require the furnishing of geological reports by the operator to the investors and the court specifically finds that the failure to employ a geologist does not amount to a withholding of necessary information from potential investors. Although the plaintiffs were unsophisticated, they had about as much means of acquiring information and knowledge as did the defendant.

18. The fact that the defendant had cost overruns is not a result of any intentional act on the part of the defendant and the plaintiffs knew, or should have known, that additional costs would be due

for the well completion. The fact that some of the wells failed to produce sufficient hydrocarbons to repay the costs of drilling and completing the well, is one of the hazards of the industry and an operator never guarantees or insures the success of any venture. The plaintiffs voluntarily and knowingly invested in a risky venture which failed to pay off.

19. The fact that Dow Keith removed equipment from one well to another which did not have common investors was poor business judgment, but he did this not to harm anyone, but on the contrary, to do what he believed would be helpful to everyone in saving costs.

20. The court believes that defendant did employ telephone lines and the mails in connection with the selling of these undivided working interests in the Fuqua, Smith, and Gibbs leases, but the defendant

did not make a public offering of these working interests.

21. The errors in billings for operational expenses on the Smith and Fuqua leases were inadvertent and unintentional and were corrected when discovered and resulted in no damage to the plaintiffs.

22. The completion of the two wells on the Gibbs lease was a reasonable business venture, and although it did not pay out, the defendant could, and likely would, have been soundly criticized had he not completed these two wells.

23. The failure of the defendant to supply plaintiffs with an AFE (Authorization For Expenditures) was not an attempt to deceive. As above indicated, the defendant operates a "shirttail operation" and does not and could not economically hire accounts or cost engineers in his business. Plaintiff's argument in this regard might be plausible

if defendant were a big operator drilling deeper holes.

24. Although defendant allowed other investors in the Gibbs wells to transfer their interests to the Smith lease, this transaction was satisfactorily explained to the court and was done without any intention to harm anyone. The defendant would have allowed plaintiffs the same privilege had the circumstances been the same as with the Weavers.

Conclusions of Law

1. The plaintiffs have failed to sustain their burden of proof in this case under the Securities Acts, both of the state and federal government, in that there was no fraud, deception, or misrepresentation practiced and there was no failure to reveal material facts in connection with the sale of the undivided working interests to the plaintiffs.

2. Activities by operators such as those engaged in by the defendant do not call for detailed, sophisticated information for the benefit of potential investors as would be required by the court for deeper, more expensive exploration. Although this court would not condone the giving of misleading or false information in any case, and would find for plaintiffs if it believed any deception was practiced, in this case the court does not believe that for the type of operation the defendant conducted he is require to hire geologists and accountants and other experts as are generally employed and required in the deeper, more expensive operations.

3. The court finds the issue generally in favor of the defendant and against the plaintiffs.

The Clerk of the Court is instructed to mail a copy hereof to the counsel of record in this case.

DATED the 9 day of February, 1983.

/s/ Luther B. Eubanks
LUTHER B. EUBANKS
United States District Judge

APPENDIX D

JANUARY TERM - February 10, 1986

Before Honorable William J. Holloway, Jr., Honorable James E. Barrett, Honorable Monroe G. McKay, Honorable James K. Logan, Honorable Stephanie K. Seymour, Honorable John P. Moore, Honorable Stephen H. Anderson and Honorable Deanell R. Tacha, Circuit Judges.

R. S. COWLES and GLORIA B. COWLES,	)	
Plaintiffs-Appellants,	)	
v.	)	No. 83-1464
DOW KEITH OIL & GAS, INC., an Oklahoma corporation and DOW KEITH, an individual,	)	
Defendants-Appellees,	)	
OKLAHOMA DEPARTMENT OF SECURITIES,	)	
Amicus Curiae.	)	

The Court has considered the petition for rehearing with suggestion for rehearing en banc filed by the appellant, and the response thereto. Judge Doyle did not participate. Judge Barrett voted to deny the petition for rehearing and did not request a poll of the Court on the en banc

suggestion. Judge McKay voted to grant the petition for rehearing and to adopt his dissenting opinion but he did not request a poll of the Court on the en banc suggestion. No member of the Court voted to grant rehearing en banc and no member of the Court requested a poll on the en banc suggestion.

In light of the fact that two of the panel judges are evenly divided on the petition for rehearing, same is denied by an evenly divided panel.

No panel judge nor any active judge of the Court having voted for en banc rehearing or having requested a poll of the Court thereon, same is denied.

HOWARD K. PHILLIPS, Clerk

By /s/ Robert L. Hoecker
Robert L. Hoecker
Chief Deputy Clerk